

**Statement of Peter G. Esposito, Senior Vice President & Regulatory Counsel
on Behalf of Electric Power Supply Association and Dynegy Inc.**

Before the House Subcommittee on Energy & Air Quality

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Mr. Chairman, and members of the Committee, thank you for allowing me to speak here today on behalf of the Electric Power Supply Association. EPSA is comprised of generators and marketers of electric power. I also speak on behalf of Dynegy, a marketer and generation owner, and a member of EPSA.

Those familiar with the energy situation that developed in California over the last year will agree that incorrectly restructuring the power industry can have dire consequences. Armed with this knowledge, you may quite naturally ask: "why should I touch power; it could be just another political third rail?"

The simple answer is that just because California didn't do it right doesn't mean the Nation as a whole can afford not to do it at all. Now more than ever, power is the lifeblood of the American economy. Growth in demand must be matched by growth in supply and improvements in an aging delivery infrastructure. Today, some regions are on the edge of a supply demand imbalance. This imbalance will only get worse unless we change today's regulatory paradigm of a patchwork of ever-changing rules being issued under an aging statute.

While those who supply and transmit power need modern rules they can rely on, consumers simply want power that is reasonably priced and reliable. They don't want to be surprised by price spikes or blackouts, especially given the increased threats we now face.

Incumbent monopolies have a legal *obligation* to provide reliable service at any price. New entrants are aligned with consumers because they know that they will not be successful unless they actually provide consumers reliable power at a reasonable price.

How do we achieve these reliability and price objectives simultaneously? Everyone seems to have an idea,

- Do we have the government build power plants to create a reserve? That would be folly unless we want the government to build all the plants. Otherwise the private sector would simply back off its new construction until equilibrium of supply and demand was created. No one is going to build power plants in a glutted market if they are not going to get back their investment and some return on that investment.
- Do we require public utilities to build more generation? Go back to the "good old days?" Remember what got us here was overbuilding during the rate-based "nothing's too good for the ratepayers" construct, where the ratepayers are on the hook to pay for virtually anything and everything the utilities build, whether it is economic or not. Can our economy afford to pay large premiums on power year

after year under the old regulated regime while our competitors in the rest of the world adopts the new deregulated regime? Of course not!

And how *do* we satisfy your constituents and our customers? We can satisfy their desire for reliability at reasonable prices through competitive markets that allow customers to choose from a variety of suppliers and products that reflect the balance of price and reliability risk those customers choose to assume. It is amazing in this United States what the profit incentive can do to assure that products are on shelves in abundant supply.

Establishing competitive markets does not involve nuclear physics. It does, however, require some common sense and a big-picture view.

There are three perspectives this Committee must consider when addressing electric restructuring. These are the perspectives of:

1. **Generators:** those who produce the product and who need easy entry to markets, signified by access to the grid
2. **Transmission owners:** those who deliver the power, who need roadblocks to grid expansion removed, and
3. **Consumers:** those who purchase and consume power, and who deserve power that is reasonably priced and reliable.

These are the three basic players in any market. Each needs to be empowered.

This is not rocket science. We need to assure that the raw material—energy – can be *produced* in large quantities and *transported* flexibly to the points where *consumers* want to use it. Much as the space program gave us great political and technological benefits, forging flexible markets gives us a double benefit: By training us to reconfigure systems to make economic sense on an hourly basis, vibrant, flexible markets also help mitigate the impacts of nefarious attacks on our infrastructure.

More specifically:

First, from the production side, you must assure generators **easy entry to markets**.

In power industry parlance, this means assuring that new generation can get interconnected to the grid and that, once connected, it is able to reach many consuming markets under reasonable contractual terms *and* at a price that is reasonable and determinable in advance.

Bearing in mind that transmission is presently a monopoly and will be for some time, this means:

- establishing base-line **interconnection rules** for all markets, in all states, that require transmission owners to provide new generators with open access to their delivery systems, even when those new generators compete with generation owned by those who control the wires.

One means of assuring that wires owners do not restrict access to wires in order to favor their own generation is to separate the control of wires from control of competing generation. FERC plans to do this through the formation of large Regional Transmission Organizations (RTOs), in effect pooling the transmission assets of many utilities under one independent operator. Congress should affirm FERC's authority to compel membership in RTOs by all transmission providers.

The mere formation of RTOs, however, is not enough to assure that markets can do their job effectively. We must:

- Assure that each RTO has **open access tariffs** that facilitate the movement of power from many generators to many consumers. These tariffs must apply fairly and across the board to *all* users of the transmission system so as to assure each a chance to compete, both in the sale and purchase of energy.
- **Deal with "seams" issues between transmission providers.** Today's transmission system is all too often characterized by numerous relatively small franchised service areas shaped in ways that would make the best Congressional redistricters proud. To move power between regions, one must contract with each of these franchisees for transmission service. Imagine changing trucking companies at each county line when trying to truck tangerines from Tampa to Trenton. If the farmers and consumers had to pay the costs of this inefficiency, Congress would have acted decades ago to fix the problem, indeed it did by creating a national highway system with characteristics like minimum bridge heights. Yet this is how we transport power in most regions of the country today.

This vestige of the early part of the last century has stayed in place in large part due to structural and political inertia, if not outright resistance. The time is ripe to fix this, and reducing the sheer number of transmission providers by forming RTOs is, in part, the answer. So too is making RTOs large enough so that the burdens associated, for example, with moving power from Florida to the PJM are not overwhelming.

- One problem with **RTOs** is that they will, by definition, become giant monopolies. Giant monopolies generally have **no incentive to act like a competitive business** and their service tends to become “bureaucratic,” to be kind. Because customers will not have another RTO to go to for service if they don’t like their regional RTO, we must create incentives for RTOs to treat customers as customers. There are two ways to address this.
 - First, there must be some recognized means of assuring customer input is taken seriously, for example through **stakeholder advisory boards** to the RTO.
 - The second is to make RTO cost and profit recovery dependent on providing valuable service, e.g., by setting up **rate designs that are based on throughput, not merely on ownership of wires**. When the RTO does a good job, it should be rewarded; when it does not, it should not.
- **Economics of scale** must be achievable:
 - Congress should **remove artificial barriers**, including ownership restrictions included in **PURPA** and **PUHCA**.

- **FERC must be empowered to require consistent transmission business practices across the country.**

Second, from the transmission provider perspective, you must give the RTOs the tools to do their job and the ability to make a profit. This entails providing:

- **A regulatory and tax climate in which capital formation can occur.**
 - **Regulatory certainty:** Change is inevitable, but constantly changing rules need not be. Just as generators are asking for some certainty in environmental requirements and market rules, transmission owners have a right to know what is expected of them; when they will be rewarded and when they will be punished by regulators.
 - When change is required, there should be adjustments made to facilitate change. Here, tax laws changes are necessary to assure that taxable events do not occur simply because transmission assets are transferred under government request to RTO control.
 - Transmission owners must have the **right to make a profit commensurate with risk.**
- **The ability to provide better service with expanded assets.** The surest way to eliminate any semblance of generator market power is to remove all congestion from the system, so that many sellers can reach many buyers and vice-versa. This will require that something be done to facilitate siting of new transmission facilities, in what could be a very painful political process. This could occur through regional compacts, or through RTO processes, with a federal eminent

domain backstop. Again, consumers all over the nation will benefit from better markets and increased infrastructure security if we come together as a Nation to deal with critical siting issues. Whatever method of dealing with these issues is chosen, landowners must feel they got a fair shake.

- Let us not forget in this quest that there are many ways to expand transmission, through the use of existing rights of way and with new technology. New wires in new rights of way are not the only way to expand and enhance the transmission system.

Third, consumers need to be empowered.

- **Price signals:** Consumers need to be charged power they consume, so they know how much they will be billed if they consume more or less of it. Contrary to lore, demand for power in the aggregate *is* elastic, as has been proven so forcefully in California this summer:
 - where the NERC predicted 260 hours of blackout and none, repeat none, occurred, and
 - where wholesale prices came down *before* West-wide wholesale price caps went into effect, once retail prices rose.
- **Choice:** Getting wholesale markets right means establishing the foundation for customer choice. In California, had customers been able to choose the 5 to 6 cent power being offered by generators last year they would not now be shouldering the burden of much more expensive power that was purchased last winter, before

demand dropped off. We realize that the Congress is not likely to force choice on the states, but it should at least give the states wholesale markets that allow choice to go forward should the states so choose.

Finally, but most importantly, we all need market rules that set up sustainable markets, that is, markets that are fair both to consumers and suppliers of power. Just as price caps will stifle the addition of needed generation, so too will very high prices stifle the economic growth and prosperity of our country.

Both FERC and Congress have a role in assuring we meet these goals. Congress can best help consumers receive the most reliable and reasonably priced power by reaffirming FERC's authority and providing it with policy direction and appropriate flexibility to achieve these goals. The time to do this is now.